

of treating those taxes) is treated according to the shareholder's method of treating those taxes, and each shareholder may elect to use the total amount either as a credit against tax or as a deduction from income.

(d) *Effective date.* This section applies to taxable years of corporations beginning after December 31, 1992. For taxable years to which this section does not apply, corporations and shareholders subject to the provisions of section 1363 must take reasonable return positions taking into consideration the statute, its legislative history and these regulations. See Notice 92-56, 1992-49 I.R.B. (see § 601.601(d)(2)(ii)(b) of this chapter), for additional guidance regarding reasonable return positions for taxable years to which this section does not apply.

[T.D. 8449, 57 FR 55456, Nov. 25, 1992]

**§ 1.1363-2 Recapture of LIFO benefits.**

(a) *In general.* A C corporation must include the LIFO recapture amount (as defined in section 1363(d)(3)) in its gross income—

(1) In its last taxable year as a C corporation if the corporation inventoried assets under the LIFO method for its last taxable year before its S corporation election becomes effective; or

(2) In the year of transfer by the C corporation to an S corporation of the LIFO inventory assets if paragraph (a)(1) of this section does not apply and the C corporation—

(i) Inventoried assets under the LIFO method during the taxable year of the transfer of those LIFO inventory assets; and

(ii) Transferred the LIFO inventory assets to the S corporation in a non-recognition transaction (within the meaning of section 7701(a)(45)) in which the transferred assets constitute transferred basis property (within the meaning of section 7701(a)(43)).

(b) *Payment of tax.* Any increase in tax caused by including the LIFO recapture amount in the gross income of the C corporation is payable in four equal installments. The C corporation must pay the first installment of this payment by the due date of its return, determined without regard to extensions, for the last taxable year it operated as a C corporation if paragraph

(a)(1) of this section applies, or for the taxable year of the transfer if paragraph (a)(2) of this section applies. The three succeeding installments must be paid—

(1) For a transaction described in paragraph (a)(1) of this section, by the corporation (that made the election under section 1362(a) to be an S corporation) on or before the due date for the corporation's returns (determined without regard to extensions) for the succeeding three taxable years; and

(2) For a transaction described in paragraph (a)(2) of this section, by the transferee S corporation on or before the due date for the transferee corporation's returns (determined without regard to extensions) for the succeeding three taxable years.

(c) *Basis adjustments.* Appropriate adjustments to the basis of inventory are to be made to reflect any amount included in income under this section.

(d) *Effective dates.* (1) The provisions of paragraph (a)(1) of this section apply to S elections made after December 17, 1987. For an exception, see section 10227(b)(2) of the Revenue Act of 1987.

(2) The provisions of paragraph (a)(2) of this section apply to transfers made after August 18, 1993.

[T.D. 8567, 59 FR 51106, Oct. 7, 1994]

**§ 1.1366-0 Table of contents.**

The following table of contents is provided to facilitate the use of §§ 1.1366-1 through 1.1366-5:

*§ 1.1366-1 Shareholder's share of items of an S corporation.*

(a) Determination of shareholder's tax liability.

(1) In general.

(2) Separately stated items of income, loss, deduction, or credit.

(3) Nonseparately computed income or loss.

(4) Separate activities requirement.

(5) Aggregation of deductions or exclusions for purposes of limitations.

(b) Character of items constituting pro rata share.

(1) In general.

(2) Exception for contribution of noncapital gain property.

(3) Exception for contribution of capital loss property.

(c) Gross income of a shareholder.

(1) In general.

## Internal Revenue Service, Treasury

## § 1.1366-1

(2) Gross income for substantial omission of items.

(d) Shareholders holding stock subject to community property laws.

(e) Net operating loss deduction of shareholder of S corporation.

(f) Cross-reference.

### *§ 1.1366-2 Limitations on deduction of pass-through items of an S corporation to its shareholders.*

(a) In general.

(1) Limitation on losses and deductions.

(2) Carryover of disallowance.

(3) Basis limitation amount.

(i) Stock portion.

(ii) Indebtedness portion.

(4) Limitation on losses and deductions allocated to each item.

(5) Nontransferability of losses and deductions.

(6) Basis of stock acquired by gift.

(b) Special rules for carryover of disallowed losses and deductions to post-termination transition period described in section 1377(b).

(1) In general.

(2) Limitation on losses and deductions.

(3) Limitation on losses and deductions allocated to each item.

(4) Adjustment to the basis of stock.

(c) Carryover of disallowed losses and deductions in the case of liquidations, reorganizations, and divisions.

(1) Liquidations and reorganizations.

(2) Corporate separations to which section 368(a)(1)(D) applies.

### *§ 1.1366-3 Treatment of family groups.*

(a) In general.

(b) Examples.

### *§ 1.1366-4 Special rules limiting the pass-through of certain items of an S corporation to its shareholders.*

(a) Passthrough inapplicable to section 34 credit.

(b) Reduction in passthrough for tax imposed on built-in gains.

(c) Reduction in passthrough for tax imposed on excess net passive income.

### *§ 1.1366-5 Effective date.*

[T.D. 8852, 64 FR 71644, Dec. 22, 1999]

## **§ 1.1366-1 Shareholder's share of items of an S corporation.**

(a) *Determination of shareholder's tax liability*—(1) *In general.* An S corporation must report, and a shareholder is required to take into account in the shareholder's return, the shareholder's pro rata share, whether or not distributed, of the S corporation's items of in-

come, loss, deduction, or credit described in paragraphs (a)(2), (3), and (4) of this section. A shareholder's pro rata share is determined in accordance with the provisions of section 1377(a) and the regulations thereunder. The shareholder takes these items into account in determining the shareholder's taxable income and tax liability for the shareholder's taxable year with or within which the taxable year of the corporation ends. If the shareholder dies (or if the shareholder is an estate or trust and the estate or trust terminates) before the end of the taxable year of the corporation, the shareholder's pro rata share of these items is taken into account on the shareholder's final return. For the limitation on allowance of a shareholder's pro rata share of S corporation losses or deductions, see section 1366(d) and § 1.1366-2.

(2) *Separately stated items of income, loss, deduction, or credit.* Each shareholder must take into account separately the shareholder's pro rata share of any item of income (including tax-exempt income), loss, deduction, or credit of the S corporation that if separately taken into account by any shareholder could affect the shareholder's tax liability for that taxable year differently than if the shareholder did not take the item into account separately. The separately stated items of the S corporation include, but are not limited to, the following items—

(i) The corporation's combined net amount of gains and losses from sales or exchanges of capital assets grouped by applicable holding periods, by applicable rate of tax under section 1(h), and by any other classification that may be relevant in determining the shareholder's tax liability;

(ii) The corporation's combined net amount of gains and losses from sales or exchanges of property described in section 1231 (relating to property used in the trade or business and involuntary conversions), grouped by applicable holding periods, by applicable rate of tax under section 1(h), and by any other classification that may be relevant in determining the shareholder's tax liability;

(iii) Charitable contributions, grouped by the percentage limitations